

**A TAXONOMY OF
REVENUE AND EXPENDITURE
RESTRAINTS**

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A TAXONOMY OF REVENUE AND EXPENDITURE RESTRAINTS

Introduction

During the inflationary era of the late 1970s and early 1980s, a number of states either adopted or seriously considered one or more limits on state and local revenues and expenditures. Many of them, such as Proposition 13 in California and the "2 1/2 Percent Solution" in Massachusetts, received a great deal of publicity and led many to the conclusion that such limits represented a new departure for states and localities in the United States.

In fact, these initiatives are simply part of a much larger family of revenue and expenditure restraints that have been adopted over a long period of time with varying objectives and varying degrees of success. Some of these restraints may not even have been intended as such, but may nevertheless have that effect in one way or another.

It is the purpose of this document to outline the methods by which states and localities in the United States have addressed the issue of revenue and expenditure restraint. It will be noted that the restraints reflect the unresolved debate over the preferred way to control the growth of government: Do we control revenue growth by limiting the growth of expenditures or do we control expenditure growth by limiting the growth of revenues? The taxonomy is built along these two basic approaches.

The outline is intended only as an aid to thinking about the range of options available. It makes no judgment as to the likely impact of any measure or combination of measures and should in no way be construed as an endorsement of any specific approach to the limitation of governmental growth.

Revenue-based Limitations

- I. Overall limit on revenues (or major portion, such as general fund).** Restraints of this kind do not single out a particular revenue source but, instead, attempt to limit the overall growth of the revenue structure of the jurisdiction.
 - A. Limit on revenues in relation to another measure.
 - 1. Indexation. The growth of revenue may be tied to a measure such as the Consumer Price Index, GNP Price Deflator, or other index of economic activity.
 - 2. Proportional Limit. Total revenue may be limited to a proportion of some other indicator of economic activity, such as state personal income. Such a limit may be either:
 - a. Fixed.
 - b. Declining.
 - B. Arbitrary limit on increase in revenues. This may be a simple limitation of growth to a specified percentage per year.
- II. Limit on specific revenues.** Such limits target certain revenue sources, often the property tax, permitting growth to occur in other revenues.
 - A. Declaration that certain revenue sources are illegal (or failure by legislative body to authorize a given revenue source).
 - B. Cap on rate (or reduction in rate).
 - C. Cap on base (or reduction in base). May apply to entire jurisdiction or to individual taxpayers.
 - 1. Cap on growth of existing base (or reduction of base).
 - 2. Cap on additions to base (or increase in exemptions).
 - D. Cap on levy, or total revenues (which is the same as a reduction in the rate in an inflationary environment). Includes "truth in taxation," which requires taxing body to vote to levy portion of tax attributable to growth in the base.
- III. Limit on progressivity of taxes.** Theory is that total taxes will be held down if taxes on lower-income individuals rise proportionately to those on upper-income individuals.
 - A. Broaden base by limiting exemptions, credits.

B. Same rates for all income classes.

IV. Procedural limits on growth of revenues. This approach assumes that if extraordinary procedures, such as a public vote or supermajorities, are required, legislative bodies will be less likely to adopt unnecessary tax increases.

A. Characteristics of vote.

1. Public vote.
2. Legislative body vote.
3. Simple majority.
4. Extraordinary majority.

B. Subject of vote.

1. Increase in rate (or continuation of existing rate).
2. Increase in existing base of tax.
3. Additions to existing tax base.
4. New forms of taxation.

Expenditure-based Limitations

I. Overall limit on expenditures. Limit does not target specific items of expenditure, but attempts to control overall level of spending. Same concept as item I. under revenue-based limitations.

A. Limit on expenditures in relation to another measure.

1. Indexation.
2. Proportional limit.
 - a. Fixed.
 - b. Declining.

B. Arbitrary limit on increase in expenditures.

II. Limit on specific expenditures. These limits normally target items that may be considered inappropriate for governmental involvement, such as subsidies to certain forms of private enterprise or the issuance of certain kinds of debt. Limits for most items of expenditure are normally left to the budget and appropriations process.

A. Declaration that certain kinds of expenditures are illegal.

B. Limiting certain expenditures to the level of specific revenue sources.

1. User charge financing.

2. Earmarking of revenues that would normally be used to support general purposes.

C. Arbitrary limits on specific expenditures. These limits are most frequently applied in relation to the issuance of debt, although they might also apply to operating expenditures. They are often expressed as a proportion of the tax base.

1. General expenditures.

2. Limits on the issuance of debt.

III. Budget Process Limits. The budget process affords several opportunities to impose expenditure limits, although these tend to be less structured and rigid than some of the other possible approaches.

A. Fiscal stability devices.

1. Balanced budget requirement. Assures that if expenditures are increased, revenues will have to be raised to cover them.

a. Executive must propose balanced budget.

b. Legislative body must adopt balanced budget.

c. Operating deficit cannot carry over from one fiscal period to the next.

2. Budget stabilization ("Rainy Day") fund. Provides cushion during economic downturns so that jurisdiction can adjust to lower-than expected revenues; limits available revenues during economic expansions, thereby limiting growth of expenditures.

a. Budget-driven. Bases deposits to fund on some aspect of the budget (surplus, excess of revenues over estimates, etc.).

- b. Economy-driven. Bases deposits to fund on some external indicator of economic condition (e.g., personal income growth)
 - B. Budget format. Attempts to rationalize budgetary decisions through various procedures and means of packaging.
 - 1. Program budgeting. Considers proposed expenditures according to their purposes.
 - 2. Zero-based budgeting. Forces justification of base of program, not simply incremental changes.
 - C. Program termination.
 - 1. Sunset laws. Intent is to force programs to justify themselves periodically or be terminated.
 - 2. Line-item veto. Permits executive to terminate selected programs without vetoing entire appropriations measure.
- IV. Procedural limits on growth of expenditures.** Same concept as in item IV. under revenue-based limits.
 - A. Characteristics of vote.
 - 1. Public vote.
 - 2. Legislative vote.
 - 3. Simple majority.
 - 4. Extraordinary majority.
 - B. Subject of vote.
 - 1. Overall budget.
 - 2. Specific items of expenditure.
 - a. Debt.
 - b. Pensions.
 - c. Collective bargaining agreements.